GRIFFIN

Financial Readjustments of the Seaboard Air Line Railway

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FINANCIAL READJUSTMENTS OF THE SEABOARD AIR LINE RAILWAY

BY

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I HEREBY RECOMMEND THAT THE THESIS PREPARED UNDER MY SUPERVISION BY

Clare Elmer Griffin

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Introduction

The Seaboard Air Line is a Southern road. In many ways it is a typical Southern road and its problems are the problems of other roads of that region. The main line of this railway stretches from Richmond, Virginia, thru the southern part of that state, thru the central part of North and South Carolina, along the eastern coast of Georgia and on south to Tampa Bay in Florida. This main line is 841 miles in length. There are three principal feeders which run due west from the main line. The northernmost of these extends to Atlanta, Georgia and Birmingham, Alabama; the second from Savannah on the main line to Montgomery, Georgia; the third from Jacksonville thru the narrow northern strip of Florida to the Catahoochi River where it connects with the Louisville and Nashville line to New Orleans. The total length of all lines operated is 3,101 miles.[1]

At present the railway predominance in the South Atlantic states is divided between three great roads in a somewhat orderly manner, the general arrangement being that the Southern Railway occupies the highlands and the western part of the coast plain; the Seaboard Air Line occupies the center of it; and the Atlantic Coast Line the eastern part, but all three companies compete at most of the principal cities either directly or thru affiliated companies. In addition there is still a very large unabsorbed mileage of short lines. In

1. Annual Report, June 30, 1914.

Georgia alone with only 6,829 miles of railway there 62 operating companies. Thus the Seaboard Air Line has thruout its career been subject to active competition. This fact makes it rather remarkable that the Seaboard has existed to the present time as an apparently independent system.

The traffic of the Seaboard Air Line was made up as follows in 1914.[1]

	Tons	Per Cent
Products of Agriculture	1,488,562	14.30
Products of Animals	124,250	1.19
Products of Mines	2,743,137	26.35
Products of Forests	2,581,053	24.79
Manufactures and Miscellaneous	3,473,984	33.37
	10,410,986	100.00

It has been well said[2] that the function of the Seaboard Air Line is to collect the raw products of the South, and its fruit and vegetables and to carry them to the centers of manufacturing and to the Northern produce markets; then to assemble in the North that general merchandise which is there produced and distribute it among the southern seaboard states, as well as even ship it west of the Mississippi. Much of the traffic is local. The average haul for cotton is estimated[3] to be about 200 miles, for fertilizer, the transportation of which forms a considerable part of the roads business, the average haul is perhaps 150 miles. The other two roads are somewhat more favorably situated as to traffic. The Southern

1. Annual Report, June 30, 1914 - p. 26
2. Railway Age Gazette
3. ibid. estimates by Ray Morris, Managing Editor of Railway Age Gazette

Railway handles a larger proportion of thru business while the Atlantic Coast Line has better towns and gets more phosphate rock from Florida and more vegetable traffic in the Carolinas.

The Seaboard Air Line Railway Company is the result of consolidation. Parts of the road date back to the very early construction of railways in this country. The Portsmouth and Roanoke for example, was chartered in March 1832. In 1843, the part of the line lying in North Carolina was seized for the payment of debts. New corporations were then formed in North Carolina and Virginia,and with permission of the legislatures of the respective states the two corporations were consolidated in 1849 under the name of Seaboard and Roanoke Railway Company.[1] This formed the nucleus of the present system. In 1882 the Seaboard and Roanoke obtained a controlling interest (by purchase of stock) in the Carolina Central Railway.[2] It also obtained,in like manner,control of the Raleigh and Gaston Railway which in turn held a controlling interest in the Raleigh and Augusta Air-Line Railway.[3] These four roads made up a loose system known as the Seaboard Air Line System with a total line of 516 miles. Each road maintained its own organization and issued separate reports. By 1898 the Seaboard Roanoke and the Raleigh and Gaston had jointly leased the Georgia, Carolina and Northern, a line of 266 miles, extending from Monroe, North Carolina to Atlanta, Georgia. This,with other short lines leased or held by stock ownership,brought the mileage of the system up to 951 miles in 1898.

1. Poors Railway Manual 1888 - p. 646
2. Poors Railway Manual 1883 - p. 430
3. Poors Railway Manual 1883 - p. 435

In the next chapter, the financial history of the road will be taken up at this point and brought down to 1909, but here it may be well to correlate in briefest form the main events of that history. During 1898-1900 a consolidation was effected of the Seaboard system as above described and the Georgia and Alabama Railway and the Florida Central and Peninsular system. This formed the Greater Seaboard Air Line, so-called to distinguish it from the earlier loose affiliation. Soon after the consolidation financial troubles began which finally forced the road to apply to New York bankers for assistance, and led to the formation of the Seaboard Company - a holding company. This may be called the reorganization of 1905. It should be regarded as an unsuccessful effort to ward off impending failure. The system was unable to withstand the depression of 1907 and 1908, and was consequently placed in the hands of receivers under whom it was reorganized and discharged from receivership in 1909.

A statement of some facts concerning this period 1898 to 1909 may be of interest in the present connection as it will perhaps explain the causes of the failure and thereby show some of the problems with which it was necessary to deal in any successful plan of reorganization.

I

EVENTS LEADING TO THE FINANCIAL READJUSTMENT OF 1905

(1898 to August 1904)

In December, 1898, steps were taken to bring about a consolidation of the roads that now form the Seaboard Air Line Railway. At this time, the Georgia and Alabama Railway (457 miles) was controlled by a syndicate, headed by John L. Williams and Sons of Richmond, Virginia, and Middendorf, Oliver and Company, of Baltimore. This syndicate then purchased a controlling share in the Seaboard Air Line system and in February, 1899, obtained in like manner control of the Florida Central and Peninsular system.[1] The three lines, thus brought under a unified control, formed the basis of the new consolidation. When consolidated into the new company, the mileage, stocks, and bonds of the individual companies were substantially as follows:-[2]

	Miles	Stock	Bonds
Seaboard Air Line Railway	951	$7,258,650	$14,160,000
Georiga and Alabama Railway	457	9,350,000	5,405,000
Florida Central and Peninsular System	941	24,500,000	9,820,000
Total	2,350	$41,108,650	$29 ,385,000

It was rumored[3] that the price offered for Seaboard and Roanoke stocks was $200 for every $100 share. There was some

1. Poor's Railway Manual 1899 - p. 441
2. Railway Age Gazette, April 6, 1900
3. Railway Age Gazette, January 1, 1899

suspicion at the time that the purchases were being made for the Southern Railway or for the Atlantic Coast Line. In answer to such rumors, John Shelton Williams, president of the Georgia and Alabama Railway, and the moving spirit of the consolidation, made official statement that the Seaboard Air Line would be operated as an independent system.

An interesting contest took place in connection with this consolidation. It will be remembered that the Seaboard and Roanoke Railway was a part of the old Seaboard Air Line System. Therefore, for the syndicate to purchase a controlling share in the Seaboard Air Line System, meant that it must purchase a controlling share in the Seaboard and Roanoke Railway. The total issue of Seaboard and Roanoke stock was $1,388,400 of which about $832,100 was held in the Hoffman pool. All the stock in this pool was subject to sale upon the vote of three-fourths in amount of the certificates of deposit representing the same. Thomas F. Ryan owned about one-fourth of the Seaboard and Roanoke stock, but not as large a proportion of that in the pool. For two years past he had been trying to get control of the property of the Seaboard system. Consequently, he strongly opposed the sale of this stock, and applied to the court for an injunction to prevent his shares in the pool being sold. His application was denied, and the consolidation went on as planned. In this incident is a clash of personal interests whose contests for control form a large part of Seaboard financial history.

Syndicate certificates, representing the purchased shares, were sold to the public, but the management remained in the

hands of the syndicate and later in the hands of a voting trust.

There were a number of gaps between the three consolidating lines. Work was begun at once to close these. The Richmond, Petersburg and Carolina Railroad Company was formed, and immediately issued $2,500,000 of 5 per cent bonds to raise funds for the construction of 103 miles of road connecting the line at Ridgeway, North Carolina, with Richmond, Virginia. The Seaboard Air Line guaranteed the bonds. The Florida Central and Peninsular extended only as far north as Columbia, South Carolina. A line was built 90 miles northeast to connect it with the old Seaboard Air Line.[1] From Richmond north to Washington it was planned to lease or get trackage rights over the Richmond, Fredericksburg and Potomac Railroad. So many other lines, however, were interested in obtaining the same rights that it at first looked hopeless for the new system. Finally, however, the six lines interested, namely: Pennsylvania Railroad Company, Atlantic Coast Line Railroad Company, Southern Railway Company, Chesapeake and Ohio Railway Company, Baltimore and Ohio Railroad Company, and the Seaboard Air Line Railway, united and formed the Richmond-Washington Company which was to purchase a majority of the voting stock of the desired line. Each of the six roads hold an equal amount of the voting stock of the holding company.[2] Arrangements were also made by the Seaboard for trackage rights over the Pennsylvania lines into New York City. This completed a thru route from New

1.
2. Annual Report of Seaboard Air Line Railway, 1901 - p. 5.

York to Tampa, Florida, 75 to 100 miles shorter than the existing lines.[1]

Hopes for the new system were high, and they seemed justified for in the calendar year of 1899 the separate roads, now consolidated, earned enough to pay all their interest and rentals and have left a surplus about $1,000,000. The year ending March 1, 1900 gave the following results:-

Gross earnings	$9,450,000
Net earnings after deducting operating expenses	2,660,000
Fixed charges	1,460,000
Surplus	$1,200,000

Therefore, it was contended by John Skelton Williams, president of the company, "that these roads should make such a good showing, while operated separately and before they had begun to reap any of the advantages of increased business and of the economies of operation which will necessarily result from the consolidation, certainly promises well for the future."[2] On the strength of this optimism, and partly on the strength of new line constructed, a considerable increase of capitalization was made.[3] The authorized stock for the com-

1. Railway Age Gazette, October 27, 1899
2. ibid.
3. It will be remembered that the stock of the constituent companies had been held in a pool up to the time of consolidation when it was held by the syndicate, who issued stock certificates representing it. Likewise with this new issue a large part was held by a voting trust and the real owners only held certificates of ownership and had no voice in the management of the company. The exact proportion of stock thus held cannot be ascertained but it was sufficient to vest active control in the trustees.

pleted system was increased to $75,000,000, with the proportion of common to preferred about as 7 to 8. $62,500,000 of 4 per cent consolidated mortgage bonds covering the entire system were also authorized. At the end of the fiscal year 1901 these bonds were distributed as follows:-[1]

Outstanding	$12,775,000
Held in pledge as security for $10,000,000 collateral trust bonds	20,000,000
Reserved by trustees for redeeming the divisional bonds of the system	29,725,000
Total authorized	$62,500,000

The complete indebtedness, including equipment trust bonds, at the end of the first year (June 30, 1901) amounted to $54,948,913. It will be remembered that the bonded indebtedness of the separate roads had amounted to but $29,385,000. On practically the same property we have thus had an increase of funded debt of about 86 percent. Or stated in terms of bonds per mile; before the consolidation the separate lines of the system were bonded at $12,403 per mile; after the consolidation at $22,553 per mile. While $22,553 per mile would not be an excessive debt for a road operating in a more densely populated and prosperous territory, it was high for the Seaboard. As Professor Riply has lately pointed out[2], the over capitalization or conservative capitalization [illegible] of a road depends not on the

1. Annual Report, 1901
2. "Railroads," Vol II, - p.85

absolute amount of capitalization per mile, but on the relativity between capitalization, and earning power. By this standard the Seaboard was heavily capitalized, for 79.8 per cent of its "total income" (all income remaining after payment of operating expenses) was required in 1901 for payment of interest on bonds. This leaves out of account altogether dividends on the capital stock. The size of this bonded indebtedness will, perhaps, be better realized when we remember that such stable and rich properties as St. Paul, New York Central, and the Pennsylvania lines were at that time all bonded for less than $20,000 per mile. This statement is not made as a criticism of the policy of the road. It is quite possible that the needed money for the improvements and new equipment necessary for the operation of a large system could not have been provided in a better way. The success of the new system was not at all assured and for that reason it would have been very difficult if not impossible to raise the needed funds by sale of stock. Be that as it may, the comparatively heavy load of bonded indebtedness has been one of the causes of the road's chronic weak condition.

In the year ending June 1, 1900, about 200 miles of line had been constructed by the separate companies as described above. In the first fiscal year of the new system (ended June 30, 1901) little road building was done but the rolling stock was considerably increased. This year showed a surplus of $329,659 after paying fixed charges and a dividend of 1.3 per cent on the preferred stock - the last dividend, it may be noted, that was paid on this stock until 1914.

In 1902 and 1903 the gross earnings steadily but slowly increased, and as no dividends were declared there was left for 1902 a surplus of $820,256 and for 1903, $832,480. But during this time the funded debt was increased. When $3,400,000 of 6 per cent certificates of indebtedness came due in 1902, $8,000,000 of collateral trust bonds were issued to redeem them, and at the same time to furnish money "to meet installments on car trusts, to pay floating debt, and to provide a fund of at least $1,000,000 for additional improvements."[1] The issuing of long time bonds to meet installments on car trusts and to pay floating debts, should be resorted to only in case of necessity. During the year 1902 there was practically no addition to the rolling stock, and not a great amount of work done in improving the road bed. In 1903 a considerable addition to the number of cars was made, but all were paid for by equipment trust bonds - making a total addition to that form of indebtedness of $1,605,000 in the one year. In the same year, only $638,431 of the outstanding equipment trust bonds were paid off, leaving a large increase in this item.

Another point that gives evidence of the financial condition of the road is the poor quality of track (originally intended for local traffic), added to the fact that in the first three years the management had been unable materially to improve it. Light steel rails or iron rails are direct evidence that the road is not being operated economically. Light rails necessitate a small train load, and that means high

1. Railway Age Gazette, July 5, 1901

operating expenses. In 1901, 1961 miles of the 2603 miles were laid with steel weighing 60 pounds per yard of rail or less, or iron rails.[1] The improvement of this part of the property was much needed, but such an improvement required a supply of ready money. The need of this department seems to have been typical of the general conditions of the roadway and equipment. Furthermore there was a large and increasing current indebtedness. In short, the road had been showing all the signs of weakness that usually precede a failure.

In October, 1903, came the announcement that two of the most prominent banking houses of the South were financially embarrassed, and had found it necessary to ask the indulgence of their creditors. These were John L. Williams and Sons of Richmond, and J. William Middendorf and Company of Baltimore.[2] These companies had invested large sums in developing the South, and because of the unprofitable nature of some of these enterprises, and of the extraordinary financial situation of the latter part of 1903, this condition had come about. Both of these houses had been heavily interested in Seaboard affairs, and had been the financial backers of the road. The immediate effect of this announcement was, therefore, a drop of 11 points in the quotations on the New York Stock Exchange for Seaboard Air Line 4 per cent, first mortgage bonds. These had stood at 85½ on July 5, 1902, 79½ on July 3, 1903, 76 September 25, and then, as a result of this failure, dropped to 65 in the next three weeks.[3]

1. Annual Report for 1901
2. Chronicle, October 3, 1903
3. Quotations from Chronicle for the several dates. See table No. in Appendix.

Up to this time Southern capitalists had been in control. Now it became necessary to seek financial aid in other quarters. Thomas F. Ryan, who had tried to get control of the old Seaboard Air Line system in 1897 and 1898, and, failing in this, had tried to block the sale of stock to the syndicate in 1899 and 1900, now stood in a strategic position. The road was in need of money and he was in a position to furnish it. Of course he and his associates insisted upon a share in the control of the company. Ryan's representatives were therefore elected to membership on the voting trust.

Here must be mentioned another group who would have to be considered in apportioning the control of the company. That is the Rock Island-Frisco group. In August of 1903 came the report[1] that a large, if not a controlling, interest in the Seaboard Air Line Railway had been acquired by capitalists represented by B. F. Yoakum, president of the St. Louis and San Francisco Railway, and H. Clay Pierce, a leading stock holder in the Mexican Central Railway, and Okleigh Thorne of the North American Trust Company of which Mr. Yoakum was a director. As the Rock Island-Frisco combination had been recently perfected, and the same group held an active interest in the Mexican Central, a glance at the railway map will show that to add the Seaboard Air Line to this group would give a continuous route of affiliated lines from Mexico City to New York by way of El Paso and Birmingham, Alabama. The mutual benefit possible in traffic relations was cited at the time as the reason for the affilia-

1. Chronicle, August 15, 1903

tion. It is also entirely possible that the financiers, mentioned above, seeing the weak condition of the Seaboard Air Line Railway desired a hand in the readjustment of finances which it was evident would soon be necessary. The probability of such a theory is increased when we note that this affiliation was not long continued after the readjustment of 1905.

The shares of the company not having paid dividends since 1901, and having little prospect of paying in the immediate future, were selling at a low rate. It was estimated by contemporary financial writers,[1] that the prices paid in the above transaction was 15½ for common, and 30 for preferred stock. The shares were obtained from the Southern shareholders who, because of the money stringency, could not meet the maturing loans against which the shares were pledged.[2]

So we have three groups demanding representation in the voting trust: (1) The original Southern capitalists, (2) The Frisco Railway and its allied banking houses and, (3) The Blair-Ryan-Old Colony Trust Company combination which was to furnish the needed new capital. Upon completion of negotiations in November each of the above interests was given a representation of five members on the board of directors.

The announcement that New York capitalists were to furnish needed capital tended to strengthen confidence, and Seaboard Air Line bonds regained 7½ of the 11 points they had lost, standing on November 21 at 72½.

In the latter part of November, an arrangement was made for

1. New York Sun, August 14, 1903
2. Chronicle, August 15, 1903

a loan of $2,200,000 secured by certain bonds and stocks. At the end of December, provision was made for an additional loan of $750,000.[1] On January 3,1904, $5,000,000 of 5 percent, collateral trust bonds due March 1, 1907 were offered for sale. It may be said here by way of parenthesis that the falling due of this issue of bonds during a period of high money rates was one of the immediate causes of the failure of 1907. The shareholders were to be given first preference in the purchase of these bonds to the extent of 10 per cent of their holdings. With each $1,000 bond was offered a bonus of $900 of preferred stock and $1,600 of common shares.[2] While both of these shares were valueless as to dividend paying power at that time, their method of issue is significant in determining the amount of consideration that should be given to them in a general reorganization of finances. The issue was underwritten by a syndicate composed of the New York bankers above named.

On January 2, owing to the change of control, Vice-President Barr was elected to the position of president - succeeding John Skelton Williams, who still, however, retained a position of considerable power as chairman of the board of directors. The new president was committed to an aggressive policy of improvements. In his first annual report he stated that the business of the road had outgrown its facilities, and that to secure its share of the increasing business of the South, and handle it at a minimum cost, it was necessary to provide new terminals, track, and other facilities. It was also

1. Annual Report 1904 - p. 8
2. Chronicle Vol. 78 - p. 104

pointed out at this time that the Seaboard Air Line was enjoying practically as high gross earnings as its more successful neighbor, the Atlantic Coast Line, but that these earnings were frittered away by high operating expenses. If the operating ratio could be kept down as low as that of the Atlantic Coast Line it was contended that the net earnings would be sufficient to pay 4 per cent on both classes of stock.[1] For this the Williams interest (now out of control) blamed the inefficient management while the management complained of inefficient equipment. Williams and his associates insisted that new capital was not needed. Part of an official statement issued by them follows: "The company is in a thoroughly healthy financial condition. Most of the $2,500,000 loan negotiated last fall and which fell due June 1, 1904 was paid off before its maturity....The system now is absolutely in need of no further financiering unless it should be decided to undertake certain new construction...." This statement was called out by a proposal of a holding company by which more capital was to be raised but which called for an exchange of 100 shares of the old company for 60 of the proposed company. This excited so much opposition that it was at last dropped.

In this first chapter of Seaboard affairs, we have seen the practical consolidation of various disintegrated lines and the construction of new connecting lines under the syndicate headed by Southern capitalists. But owing to the poor equipment, the sharp competition of its better equipped and

1. Chronicle, December 24, 1904

perhaps better managed competitor, the Atlantic Coast Line, the new road has not met with the brilliant success predicted for it. Then we have noted the entrance of new factors into the control of the company and the subsequent discord. Finally this opposition becomes so clear cut that the policy of the road is practically at a deadlock, the New York interests demanding more capital and extension, and the Southern interests opposing these demands. This was the situation in August, 1904.

II

THE FINANCIAL READJUSTMENT OF 1905

This chapter will deal with the activities of the new controlling interests in readjusting the finances and extending the capitalization of the road. The changes constitute the first readjustment of the Seaboard Air Line.

On August 27, 1904, Thomas F. Ryan and his associates bought enough of the shares from the Middendorf-Williams estate to give them a majority of the voting stock. The price paid was 15 for common stock and 25 for preferred. As a result, John Skelton Williams retired from the board of directors, and the new factions were free to proceed with a plan of increasing capital. In the following December, it was reported that a plan was being perfected for the readjustment of the finances of the company on a comprehensive basis which, it was believed, would meet the approval of the stock holders. In June, 1905, the plan was made public. As the changes actually adopted differed not materially from this plan, it may be well to examine it in some detail. It may for convenience be referred to as the first Ryan plan. It provided for the actual consolidation of the Atlantic and Birmingham, and the Seaboard and Roanoke, Railroad companies with the Seaboard Air Line Railway, and the creation by the conslidated company of the following new securities:-

First preferred, 5 per cent, stock,	$18,000,000	
Of which immediately issuable		$7,625,000
Second preferred, 6 per cent, stock,	$18,000,000	
Immediately issuable		17,923,350
Common Stock	$36,000,000	
Immediately issuable		35,446,930
Total authorized	$72,000,000	
Total		$60,995,280

This stock was to be exchanged for the outstanding Seaboard Air Line stock according to the following plan:-

Each $100 of the existing preferred stock to pay $12.50 cash. Receives:

first preferred stock	$12.50
second preferred stock	75.00
common stock	12.50

Each $100 of the existing common stock to pay $12.50 cash. Receives:

first preferred stock	$12.50
common stock	87.50

The Southern group immediately attacked this plan, especially that part of it which called for an assessment of stock. Very shortly, Williams had a plan of his own which would avoid the scaling down of stock.

The management, confronted by such active opposition, issued a detailed statement purporting to show that $7,625,000 in cash (the amount provided by the plan) was needed to meet the demands of the floating debt and to put the road on an

efficient physical basis. About $5,000,000 was to be used to improve the equipment and the road bed.

It will be noted that up to this time the Ryan plan did not call for a holding company, but merely for a consolidation of certain parts of the Seaboard Air Line which had to this time been operated as a unit because controlled by the same syndicate. It was now proposed that they should actually be brought under one charter. The holding plan which ultimately was adopted was only decided upon after it was found impossible to get all the shareholders to assent to the original plan. About 15 per cent of the shareholders persistently refused to assent to the plan, so on May 15 a statement was made public to the effect that "to avoid litigation and delay" a holding company, to be known as the Seaboard Company, would be formed on practically the same lines as the proposed plan. The holders of Seaboard Air Line stock were to exchange it for stock of the Seaboard Company on the terms above outlined, each share, preferred and common, submitting to a cash assessment of $12.50. In the case of the holding company the consent of only a majority of the shareholders was necessary, though of course, the consent of all would be desirable. The proceeds of the sale of the first preferred stocks of the Seaboard Company were to be advanced to the Seaboard Air Line Railway. In return for such money, the railway would issue its notes or mortgage bonds to the Seaboard Company. The total indebtedness for which the new company could at any time become obligated, was limited to $500,000.

The shareholders of the Seaboard Air Line consented to the issue of an additional mortgage on the property of the road to secure an issue of $18,000,000 of 5 per cent bonds to run for not more than 10 years. The Seaboard Company was organized therefore, May 15, 1905, under the laws of New Jersey.[1] Its authorized capitalization, as above described, amounted to $72,000,000. The company acquired the stock of the Seaboard Air Line Railway, as follows: preferred $21,323,600, common $25,555,300 - total $50,878,000 of a total of Seaboard Air Line stock outstanding of $60,900,000. On July 1, 1905, the plan was declared effective.

This was the first readjustment of Seaboard finances. Its principal features were (1) an assessment of the stocks, (2) an authorization of $18,000,000 additional bonds, and (3) the formation of a holding company.

An assessment of stock is always a commendable action, for it shows that the shareholders themselves have confidence in the possibilities of their property. In this case especially did it require considerable confidence in the future of the company, for the cash assessment was almost as large as the market value of the common stock, and it was 50 per cent of the market value of the preferred stock. In other words, the value of the common stock was practically wiped out by the assessment, and a payment of $12.50 per share was required for the privilege of participating in future prosperity of the company. It was provided that, in the event of a dissolution of the Seaboard Company, the holders of Seaboard first pre-

1. Poor's Railway Manual 1905 - p. 1568.

ferred stock were to receive its face value in cash. It will be noted that the amount of Seaboard Company first preferred stock given for each share of Seaboard Air Line stock was \$12.50 - the exact equivalent of the cash assessment. So, from this point of view, those paying the assessment were simply investing money. Nevertheless, the possible return of it was contingent on the future earning power of the company. As a matter of fact, the stock holders who consented to the assessment did get back the cash invested in 1912 when the Seaboard Company was dissolved. Furthermore, the stock had increased somewhat in value by that time. In 1912, the common stock ranged in value from 18 to 27½ and the preferred from 44 to 56. But in 1905, the future of the company was indeed uncertain.

Assessment is a just method of raising money, for the benefit of increased earnings accrue most directly to the shareholders, while such increased earnings benefit the other security holders only indirectly. The bond holder, in theory at least, is protected by the value of the property as it stands, but the only value of the stock depends on the earning power, either immediate or prospective, of the property while in the hands of the present owners. Therefore, if more cash is needed for immediate purposes, it is only fair to obtain it from the stockholders - the proprietors and managers of the property.

In almost every case, as Professor Daggett points out,[1] in

1. "Railroad Reorganization," - p. 354.

which stockholders have submitted to an assessment the payment has been abundantly justified by the increased earnings of the road. Of course, the use of assessments would be the soundest and best method of raising money. It has the great advantage of involving no increase in fixed charges. This has been done in certain reorganizations, but, obviously, there is a limit beyond which stockholders will not pay the assessment which in the case of the Seaboard Air Line in 1905 was necessarily quite low.

The authorization of $18,000,000 of bonds was not such a commendable feature, for, as has been shown, the road was already carrying an excessive load of fixed expenses. It is a quite general rule of reorganization to cut down the fixed expenses and raise the necessary money by sale of stocks or income bonds. However, it is true that the road was suffering more at this time from too high operating expenses than from too high interest charges. The Seaboard could better afford to have a percentage of fixed charges to gross earnings of 22.7 than it could to have a percentage of operating expenses to earnings of 71.4. Perhaps then, it was considered that the advantage gained by better equipment and consequent lower operating ratio would more than make up for the increased interest charges.

Whatever may have been in the minds of the management their policy seems to have met the approval of the investing public for the quotations for first mortgage, 4 per cent, bonds of the road rose considerably upon the establishment of the new

plan. During the first half of the calendar year 1904, the value of these bonds had hovered about 69. During July and the first part of August, while the New York capitalists were negotiating for control, quotations rose from 69 to 74. Then in the week of August 27, when these men bought the shares of the Williams estate, and thus gained entire control, the quotations rapidly went up from 74 to 82. During the weeks in which the readjustment plans were being perfected, they stood about 90. These quotations and the comments of contemporary financial writers show that, whatever we now think of the first reorganization, it met with the approval of investors of that day, and inspired confidence in the Seaboard system.

III

EVENTS LEADING TO THE RECEIVERSHIP AND REORGANIZATION OF 1908. (August,1905,to January,1908).

The financial readjustment of 1905 should be recognized as merely an effort to stave off the failure toward which the Seaboard Air Line was surely tending. It was not a thorough reorganization,but merely a plan to raise more capital. When the effect of this injection of new capital had worn off,the road was in a worse financial condition than before,tho its physical condition had been somewhat improved. The outlook,however,in the summer of 1905 was bright. The new and more powerful New York capitalists were in control; the plan which they had offered had been adopted;and,thereby, new and needed capital had been provided; provision had been made for the issuing of new bonds as it became necessary; and the road had just completed a successful fiscal year. Its gross earnings were $14,000,000,as compared with a previously high gross of $12,000,000,and it was undoubtedly thought that with the new regime the operating ratio would be lowered sufficiently to leave a considerable margin for profits. Beside all this,the depression of 1904 was past,and all indications were for a period of prosperity for the country at large.[1]

In the two fiscal years following the formation of the Seaboard Company,the gross receipts were larger than ever before, but in each year owing to high operating expenses and fixed

1. Wall Street Journal, Edition, August 1905.

charges the surplus was smaller than in the preceding year. The following figures give a brief summary of the income account for the two years in question and, for purposes of comparison, the income account of 1905:-[1]

	1907	1906	1905
Gross earnings from operation	$17,204,182	$15,800,019	$14,201,943
Operating expenses	13,585,677	11,070,757	9,600,891
Net earnings from operation	$ 3,618,505	$ 4,729,262	$ 4,601,052
Taxes	517,471	517,831	481,858
Operating income	$ 3,101,034	$4,211,431	$ 4,119,194
Other income	31,802	51,401	58,189
Total income	$ 3,132,835	$4,262,832	$ 4,177,383
Interest, rentals, etc.	3,437,026	3,131,254	3,005,474
Surplus		$1,131,578	$ 1,171,908
Deficit	$ 304,190		
Operating ratio	81.97 percent	72.97 percent	67.60 percent

A large increase in the ratio between operating expenses and gross earnings will be noted in the above figures. In 1906, 69.55 per cent of gross earnings was used in paying operating expenses; in 1907, 78.82 per cent was used in this way. Such an increase is very unusual and especially important in this case as it was due largely to this increase that the year 1907, while having larger gross earnings than in any

1. Annual Report for 1907, 1906 and 1905.

previous year of its history, actually resulted in a deficit. The increase in operating ratio in 1907 over that of 1906 was, as will be seen, about 9 per cent, ascribable as follows to the various items that go to make up operating expenses:-

Operating Expenses for Year Ended June 30, 1907

	1907	Per cent of this item to gross	Increase over 1906	Increase in points of operation ratio.
(1) Maintenance of Way and Structures	$2,205,997	13.43	$340,457	1.09
(2) Maintenance of Equipment	2,314,914	14.09	357,598	1.19
(3) Conducting transportation	7,827,312	47.65	1,671,379	6.93
(4) General Expenses	599 ,816	3.65	57,144	.06
Total Operating Expenses	$12,948,041	78.82	$2,434,580	9.27

Let us then split up these sub-items into their various parts and endeavor to find some general reasons for the consistent and large increases. The first two items are very similar, and probably are explainable on the same grounds.

(1) The increase of $340,457 in the item of Maintenance of Way and Structures was occasioned, in part, by "general repairs", charges for which increased by about $152,000, and by renewals of ties, charges for which increased by about $121,000.

(2) Under Maintenance of Equipment, repairs and renewals of

freight cars are the principal items showing increases. That each of these increases should be due so largely to repairs, seems to indicate that the management had allowed the property to fall into a bad condition,and now in a period of good earnings were going about to make up for the neglect of past years. Under the conditions existing in 1907,this may have been the best the management could do,but,viewed as a whole, it was certainly poor business policy.

The next division is that of Conducting Transportation which is the largest part of operating expenses. 47 per cent of gross earnings was used for this purpose in 1907,as compared with 40 per cent for 1906. Thru all this discussion it must be remembered that the road had handled a larger amount of traffic in 1907 than in 1906 or any preceding year.

	1907	1906	Increase
Tons of Freight Carried One Mile	1,023,498,330	965,550,942	61,947,388
Passengers Carried One Mile	160,290,375	135,826,215	24,464,160

With this increase of traffic,we would expect an absolute increase of cost of conducting transportation but hardly an increase in proportion to gross earnings. Returning to the item of conducting transportation,we find an increase of $142,178 of wages of engineers and firemen. $452,330 more was paid for fuel for engines than in the preceding year. Remembering the increase of business as above pointed out,was such an increase in fuel charges justified? The average cost per ton of coal used increased from $2.29 to $2.60.

The annual reports of the Atlantic Coast Line show that

there was no increase in the price paid for coal by that company. There was a slight rise in the general price of coal at that time [1], but hardly enough to account for the difference mentioned. Combined with this is the fact that each locomotive required more coal to run one mile than in the preceding year - in 1906 the average miles run per ton of coal was 19.41; in 1907 it was 17.48 miles. On the face of it, this seems to indicate wasteful use. However, there had been an increase of 37 in the number of locomotives in use. Now if these new locomotives had been of a larger type than the old ones, we should expect a larger fuel requirement per mile, and also a larger tonnage carried. The majority of them were ten wheel freight locomotives and the effect of the new addition was shown in the average number of tons of freight per ton mile. This was 207.63 in 1907 and 194.02 in 1906. Thus the larger locomotives and heavier train loads partly account for the increased fuel per locomotive mile. But, even allowing for this, the fact remains that there was an increase in the total amount of coal used of about 26 per cent at the same time that number of tons of freight carried one mile increased only 6.4 per cent. With large locomotives or small ones, such a result is quite conclusive proof of inefficient management. There was also a considerable increase in charges against injuries to persons.

1. The price of bituminous coal at Baltimore fluctuated as follows in the years indicated:-

(Statistical Abstract 1912.- p. 571)	1901 - $2.50	1905 - $2.60
	1902 - 2.50	1906 - 2.75
	1903 - 3.25	1907 - 2.80
	1904 - 2.25	1908 - 2.70

An increase of business should ordinarily, with efficient management, be handled at a constantly decreasing cost per unit of traffic. Especially is this true of a road such as the Seaboard, whose greatest difficulty has always been a sparsity of traffic. Each of the above items points to the one conclusion - mismanagement and wasteful operation. A writer of that day[1], comparing the Atlantic Coast Line and the Seaboard Air Line, maintained that the general line of the employees of the latter road were not as "high grade" as those of its more successful competitor. Not only, said he, was the quality of the individual workers lower, but there was lacking an "esprit de corps" and loyalty which the Atlantic Coast Line held to be a valuable asset. This is quite possibly true, and even this fault must, in the final analysis, be held against the policy of the managers.

There is one other division under the general head of conducting transportation that has not yet been discussed. This is the charge for car mileage which increased by $245,400 in the one year. Payment of a balance of car mileage shows that the road paying it has held in its own use cars belonging to other roads, and when this amount doubles in one year, as it idid in 1907 and 1906, it is probable that worn out equipment is not being replaced with new, or that the amount of equipment is not keeping pace with the increase of business. An increase of the debit due to car mileage

1. Wall Street Journal.

is therefore usually regarded as a very undesirable sign.[1] There are several reasons why railroads have not favored the extensive use of this form of security. One of them is,that,as these bonds rest on certain specified pieces of equipment,they must necessarily be for short terms,and be entirely paid off by the time that equipment is worn out. This necessity of paying a certain part of the debt on specified dates is a distinct disadvantage. It will be seen, however,that such bonds,because of the definite tangible security,could be sold even when the credit of the company is very low and therefore,despite their disadvantages, are often resorted to in cases of emergency.

In 1901,the Seaboard had $2,453,913 of this form of indebtedness; in 1904, $3,442,348,which amount by 1907 had been more than doubled, being at the latter date $7,417,000. For what purpose had this great increase in equipment trust bonds been made? It is usually assumed that railroads will use such a means of finance only to add new property,not to replace worn out equipment. Therefore,let us see what new equipment had been added to justify the equipment trust bonds. The equipment inventory (in the company's report) shows the following,in the latter three year period,mentioned above:-

	June 30, 1907	June 30, 1904	Increase
Locomotives	398	326	72

1."It is not usual for roads to make car trusts or equipment trusts, unless funds cannot be obtained in other ways, as by sale of securities. Speaking generally, car trusts are a sign of poverty, altho there are exceptions, as, for example, Pennsylvania, which has several car and equipment trusts." -Woodlock, "The Anatomy of a Railway Report," - p.26.

Passenger cars	333	281	52
Freight cars	12,411	9,994	2,417
Company cars	615	360	255

During the same three years, according to the reports of the company, equipment trust bonds were used to purchase the following equipment:-

	Locomotives	Passenger cars	Freight cars
1905	10	10	1,024
1906	30	15	1,130
1907	45	35	2,815
Total	85	60	4,969

In other words, while equipment trusts were used to purchase 85 locomotives, the inventory shows an addition of only 72; while equipment trust bonds were used to purchase 60 passenger cars, the inventory shows an increase of only 52; and while equipment trust bonds were used to purchase 4,969 cars, there was an actual increase of only 2,417. This leaves 13 locomotives, 8 passenger cars, and 2,551 freight cars, purchased in this way, in excess of the number added to the general inventory. The conclusion is that equipment trusts were used, not only to purchase additional rolling stock, but also to replace that which wore out during the three year period. When the Seaboard started to use short time bonds of this form to replace worn out equipment, nothing could save them from final insolvency except a phenomenal increase of earnings. Instead of an increase of earnings came the industrial depression of 1907 and 1908.

The president, in his report of June 30, 1906, after de-

scribing the prosperous and growing condition of the South, pointed out the urgent need for better equipment and new terminals,which would permit the Seaboard Air Line to get its share of the rapidly growing business of the South. This report was made public in October. A month later the directors decided upon,and the voting trust approved of,the issue of part of the $18,000,000 of bonds,which had been authorized by the readjustment plan of 1905. $6,345,000 of these bonds were accordingly issued to run for thirty years.[1] Then in March,when the $4,665,000 of three year collateral trust bonds came due,they were extended to May 1, 1911. These two operations increased the funded debt of the road from $63,600,000,on June 30,1906,to $6,945,000,on June 30,1907.

Another point of interest,which arose out of the formation of the Seaboard Company,is the matter of dividends. It has been noted in a previous chapter that the Seaboard Air Line had not paid dividends,either on its common or preferred stock,since 1901. This was entirely proper,for not enough had been earned to justify dividends. But with the formation of the Seaboard Company,2½ per cent,semi-annual dividends were declared on its preferred stock, the first of these on July 16, 1906. Now there was no good reason for this change of policy,for earnings were no greater than before. The only difference seems to be that under the holding company the process was not so apparent as before. A great majority (82.5 per cent) of Seaboard Air Line shareholders had exchanged their stocks,as above described,for Seaboard stock.

1. Report for 1907 - p. 7.

In other words, the shareholders now own the Seaboard Company, which in turn owns the Seaboard Air Line - the actual property. The Seaboard Company loans money to the railway, which, in turn, pays interest on this money to the holding company. The holding company then declares dividends out of the money thus received. It is evident that the same parties are concerned in one case as in the other, and, as the net earnings were not increased, the property could no more afford to pay dividends in the latter than the former case.

As has been seen by the income accounts, the year 1907 was disastrous in its results. It must be remembered that this was the fiscal year and ended June 30, so that the period of depression which preceded the panic of 1908 had not yet set in. Business conditions generally had been exceedingly favorable thruout the whole year. Had this prosperity continued, the management might have been able to make up for the deficit of 1907, in 1908. But these conditions did not remain. In August, quotations for stocks and bonds began to drop rapidly, and, by November 1, had reached the lowest point in years. At the same time, the money rates began to rise, going from 6 per cent for prime commercial paper, in August, to 8 per cent - a point never since reached.[1]

In spite of all this, the earnings for the half year from June 30, to December 31, 1907, were better than those of the corresponding months of 1906. Gross earnings for the last six months of 1907 were $319,806 in excess of those for the corresponding period of 1906, while operating expenses in-

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creased only $93,793.[1] Thus the net operating revenue (before paying taxes) was $1,833,891, as compared with $1,610,877 in the latter half of 1906, an increase of $223,014. From an operating point of view, therefore, the property was in no worse condition at the end of the calendar year 1907 than at the end of 1906, save that it looked forward to a slump in gross earnings due to the growing industrial depression.

But this statement refers only to the operating revenue from which, of course, must be paid taxes, interest, and rentals. Owing to the increase of bonded indebtedness, mentioned above, even this amount fell about $388,000 short of meeting fixed charges for the half year.

This was the condition then that confronted the management: (1) The property even in a prosperous half year was unable to pay its fixed charged. But as soon as the business depression began to affect gross earnings, as it surely would in the next six months, there would be no possibility of meeting those charges which it could not meet in prosperity. (2) There was no possibility of raising money by sale of more of the thirty-five year, 5 per cent, collateral bonds, for it would be folly for such a road as the Seaboard to try to float new bonds in such a period of tight money as then existed.[2] (3) The management alleged (and it appears to be a just complaint) that because of the money conditions it was very

1. Wall Street Journal February 28, 1908.

2. Partly due to the general financial conditions and partly due to the weak condition of the road the price Seaboard Air Line first mortgage bonds fell to the extremely low point of 59 in December. (See Chart in Appendix.)

difficult to make prompt collections.

These were the immediate causes that led the management, by order of the stockholders, to apply for a receiver on January 1, 1908.

In attempting to find the causes of the failure of the Seaboard Air Line, a comparison with the Atlantic Coast Line is significant. This principal competitor of the Seaboard was in many ways similar to it. However the Coast Line succeeded, while the Seaboard failed. Each was organized as a system at about the same time. In each year of its history the Atlantic Coast Line had successfully met fixed charges, paid dividends, and had a surplus. Some comparative facts may serve to show the weakness of the one and the strength of the other:-

	Atlantic Coast Line	Seaboard Air Line
Miles Operated	4,346	2,610
Capital Stock (Com.)	$48,537,000	$37,021,000
Capital Stock (Pref.)	$1,596,000	$23,895,000
Bonded Debt	$114,464,000	$69,945,000
Bonded Debt per Mile	$26,100	$26,760

There is here a striking difference between the outstanding capital stock of the two roads. The Seaboard, with only 2,610 miles, had a capital stock of about 61 million dollars, while the Atlantic Coast Line issued on its 4,346 miles only 50 million. However, this is not so important as it might at first sight seem, for the Seaboard had not paid dividends since 1901, and then only on its preferred stock.

This capital stock would not be a detriment to the road except in case it desired to raise more money by sale of additional stock. Aside from this, the amount of capitalization is a matter of indifference to a company, so long as it is not in a position to pay dividends on any capital. It will be noted that the bonded indebtedness per mile of the two roads was about equal.

Below is given parts of the income accounts for the two roads for 1907:-[1]

	Atlantic Coast Line	Seaboard Air Line
Gross earnings from operation	$26,771,528	$16,427,943
Operating expenses*	19,587,378	12,948,043
Net operating income	7,184,156	3,479,900
Other income	2,673,422	170,406
Total income	9,857,578	3,650,306

* This does not include taxes.

Operating ratio:-

1905	60.5	66.7
1906	64.69	72.97
1907	73.17	81.97 per cent

While the first thing that strikes us in the comparison, is the larger gross earnings of the Atlantic Coast Line, we find that, when we make allowance for the larger number of miles operated, that this road had smaller gross earnings per mile than the Seaboard. Obviously then, it was not lack of earning power that wrecked the latter road. But we find that

1. Arranged from Reports in Moddy's Manual for 1908.

the operating expenses per mile more than make up for the good showing in previous item. Here then, in the ratio between operating expenses and earnings from operation, lay the difficulty that is most strikingly shown by such a comparison. The comparative operating ratios for the years listed shows the relative efficiency of the two lines. The high operating ratio of the Seaboard was due partly to (1) an inefficient operating force and (2) to poor equipment. Even the Atlantic Coast Line was not a model of efficiency, but there are certain factors that make very low operating expenses for either of these roads difficult of attainment: - (1) They are engaged, largely, in carrying goods which are perishable, and therefore which make necessary quick service and short trains. (2) The two raods compete at so many points, and therefore shippers are in a position to demand quick service, and that again makes short trains and high operating expenses.

Let us, then, summarize the causes of failure as mentioned or implied in this chapter. They were:-

(1) Too high operating expenses for the gross earnings. This has been sufficiently dwelt upon.

(2) High funded debt. As a general proposition, the lower the funded debt, the better. It is the source of charges that do not rise and fall with varying revenue, but must be met each year to avoid foreclosure. Such charges in 1907 took about $3,500,000 of the $16,000,000 gross earnings. This point should not be over emphasized for the funded debt of the Seaboard, per mile of line, was no higher than that of

many roads which are considered in excellent financial condition. Had it not been for the other causes, this would probably not have caused trouble.

(3) Internal dissension. The conflict between the New York and Southern groups has been often touched upon. With this conflict, it was difficult to settle on a definite financial policy.

(4) Payment of dividends by the holding company when the money was needed for replacement and betterment. The payment of dividends when equipment is not being maintained intact is very much the same as paying dividends out of capital, which of course is unjustifiable, and in some states illegal.

(5) The issuing of equipment trust bonds to replace worn out equipment the expense for which should have been charged to maintenance of equipment and deducted from gross earnings.

(6) Low density of traffic owing to a rather sparse population and backward conditions of industry. This is a cause of trouble for all the Southern roads, as it was for the granger and transcontinental lines in their earlier history.

(7) The physical condition of the road from the start. The system was made up of small lines that had been doing a small business. The road bed was poor, and the rails too light for service in a system which planned to do a large through business.

(8) Because of the small profits of the road, investors

had little confidence in it, and consequently it was difficult to get new capital to remedy the defect just mentioned.

(9) The management of the road declared adverse legislation and increased taxes, to be causes of their difficulty. It is doubtful if the activities of the state and interstate-commissions would act as a cause of failure. As to taxes, there had been an increase since the organization of the road, but with the growing value of the road this should be expected. But between 1904 and 1907 there was a decrease of taxes. The taxes for the fiscal years were:-

1901	1902	1903	1904	1905	1906	1907
\$302,270	\$331,402	\$437,132	\$533,974	\$481,858	\$517,831	\$517,471

The following were immediate causes of the receivership:-

(10) Difficulty of collecting outstanding bills due to the financial situation prevailing in 1907.

(11) Necessity for extension of bonds at a time when it was practically impossible to raise new funds.

IV

THE RECEIVERSHIP

Receivership is usually looked upon as the defense of the bondholder, and as a condition to be avoided as long as possible by the stockholders, for it of course takes control out of their hands. In this respect the receivership of the Seaboard Air Line was the opposite of the general rule. On January 1, 1908, application was made for a receiver, by the attorney of the road, representing the stockholders. The application assigned drastic legislation and the financial situation as the causes of the difficulty.[1] Judge Pritchard, of the United States Court for the Eastern District of Virginia, to whom the application was made, assented to it and appointed to the position of receivers, R. Lancaster Williams and S. Davies Warfield. Later the court appointed Edward Duncan, of Raleigh, North Carolina, as a third receiver to directly represent the court. It will be noted in passing that one of the causes of difficulty had been continued by these appointments, namely, internal dissention. The first named receiver represented the Southern interests, while the second represented the New York parties. It is difficult to see why such an arrangement should have been made. It seems to

1. The road "was being pressed by its creditors and had neither the credit nor the resources with which to borrow. The condition of the money market together with the curtailment of net earnings and extraordinary expenditures has seriously affected the revenues of the company and it has been become manifest that if the system is to escape disintegration and be develpped as its opportunities permit, there must be a readjustment of its securities which will give them the stability and value to which they are entitled." - Statement by the General Counsel of the road. Wall Street Journal, January 3, 1908.

have satisfied the New York group, even though, with their preponderance of voting power, they would have been justified in demanding a larger representation than the South.

Many people thought that, under the conditions, application for a receiver was the wisest course for the management to follow. A large part of the indebtedness was still secured by bonds on the separate divisions of the road, and an actual foreclosure sale under any of these mortgages might have resulted in a disintegration of the system. But now the unity of the system was assured - for the time being, at least, - some men professed to foresee a speedy rehabilitation of the system. John Skelton Williams, formerly president, and now leader of the minority, made public the following statement: "My confidence in the possibilities of the system, under proper management is unshaken. For the calendar year of 1907, the Seaboard Air Line and its affiliated lines earned approximately $19,000,000. On this basis of earnings, over $6,000 per mile, the system ought to be operated at an expense ratio of approximately 70 per cent or less. On this basis, net earnings would have been for the past year $5,700,000 or nearly $2,000,000 in excess of fixed charges. With the return of normal business conditions and the tremendous development which has been going on vigorously for the past ten years in the entire territory traversed by the Seaboard Air Line system, the arrest of which development can only be temporary, I believe that results still more favorable than these may be comfidently expected."

Two problems are always involved in a reorganization: (1) to provide cash to discharge the floating debt, and (2) to reduce fixed charges. The former can be accomplished either by selling new shares or by assessing those already sold. The latter problem is solved either by arbitrarily cutting down the indebtedness or exchanging the bonds for shares or other securities not requiring the payment of fixed charges. Any one of these changes means a loss to some class of shareholders or bondholders. But it must be recognized that a loss has been sustained by the whole body of investors, and a reorganization from this point of view is a contest of opposing interests to determine which class, or classes, shall bear the greatest part of the loss. This reorganization was no exception to this general statement. The most pressing problem before the receivers was that of providing the money needed to discharge the Seaboard's floating debt. On June 30, 1907, current liabilities exceeded current assets by more than $6,000,000, and this amount had been considerably increased by January of 1908. True, there was an unissued reserve of bonds in the treasury, but to sell bonds of a failing company during such a financial period as January, 1908, would have been unwise, even had it been possible. The roads credit, of course, was very bad. New York financial writers[1] expressed the hope for a "strong reorganization." They asserted that to assess the stock and scale down the capitalization was the most direct and desirable method of dealing with the dilemma.

1. Wall Street Journal, January 4, 1908.

The need of a reduction of fixed charges was not so immediate. True, the fixed charges for 1907 had amounted to $3,437,027, which was about 20 per cent of gross earnings, but even that could be borne under an efficient management and better equipment.

But besides the two main problems, the Seaboard presented a third which is quite closely allied with that of paying off the floating debt, namely: to raise new funds for improvement of road bed and equipment. As mentioned in a previous chapter, the quality of road bed was very poor, and this with the consequent small train loads accounted, largely, for extremely high operating expenses. The ill-timed attempt, in 1907, to improve the standard of equipment, was, it will be remembered, one of the immediate causes of the road's difficulty. The petition for a receivership stated[1] that, in order to carry out the improvements then under way, at least $600,000 would have to be spent in the calendar year of 1908.

Before discussing the efforts of the receivers towards a reorganization, it will be necessary to describe the capital stock and funded debt - the materials with which they had to work. The statement given below is for June 30, 1909, but there had been few changes since June 30, 1907.

The capital stock outstanding amounted to $60,916,600, divided between common and preferred as follows:-[2]

1. Railway Age Gazette, January 10, 1908.
2. From Poor's Manual for 1908 and the Annual Report for 1909.

Capital Stock

	Authorized	Issued
Preferred	$25,000,000	$23,895,000
Common	50,000,000	37,021,000
	75,000,000	60,916,000

The preferred stock was at 4 per cent,and participated to the extent of 2 per cent addition after common stock was paid 4 per cent. Above this total of 6 per cent,the common stock was to get all dividends declared.

Funded Debt (total $70,631,000)

[1] (a) $12,775,000 First mortgage, 4 per cent due 1950
Of this form $75,000,000 were authorized; $67,000 had been issued and disposed as follows:-

$12,775,000	outstanding
20,000,000	pledged as security for collateral trust bonds
29,725,000	reserved for retirement underlying bonds
4,500,000	in the treasury
$67,000,000	Total issued.

(b) $10,000,000 Refunding Collateral Trust, 5 per cent, due 1911. Secured by deposit in trust of $20,000,000 of series "a"; redeemable at 105.

(c) $ 4,651,000 Three Year Collateral Trust (extended), 5 per cent due 1911.
Were due March 1, 1907 but were then extended

1. Various issues have been designated by letters to facilitate reference to them

		to 1911. Secured by a second mortgage on the Seaboard Air Line property and by $6,963,000 of stocks and bonds held in trust.
(d)	$6,345,000	General mortgage and Collateral Trust, 5 per cent due 1937. $18,000,000 of these were authorized by reorganization plan of 1905. Secured by same property as series "a" and "c".
(e)	$ 700,000	Two year Collateral Gold Notes, 6 per cent, due 1909. Secured by deposit of series "d" bonds.
(f)	$30,000,000	Divisional Bonds $27,615,000 of these have a prior lien to series "a" the property of the road.
(g)	5,853,000	Equipment Trust Obligations, average rate of interest about 5 per cent, date of final payment varying between 1912 and 1917. Secured by specific cars and locomotives.
(h)	5,760,000	Seaboard Air Line - Atlanta - Birmingham First Mortgage, 4 per cent, due 1933, secured by a first mortgage on the Atlanta and Birmingham Air Line (193 miles.)

The interests concerned in this reorganization of Seaboard finances are represented by the above classes of securities. How the receivers went about to arbitrate the opposing claims, and to adjust the losses, will now be described.

The receivers were ordered by the court to pay all in-

stallments and interest due on January 1, 1908, on any equipment trust bonds of the Seaboard Air Line Railway or its controlled companies. None of the interest coupons or car trust installments due on January 1 were paid by the management. It was evident, however, that the stockholders did not want a foreclosure on this account. As was pointed out above, such a foreclosure would have meant perhaps the disintegration of the system and it was largely to prevent just this result that the receivership had been demanded. In order to prevent a demand for foreclosure on any of these bonds Blair and Company and Ladenburg, Thalman and Company offered by advertisement on January 3 to buy the coupons maturing at that time on a long list of securities of railroads identified with the Seaboard Air Line, also the equipment bonds of the Seaboard Air Line maturing on January 1. These purchases were to be made at their face value. The court authorized the receivers to borrow $764,000, with a view to reimbursing the bankers for this outlay. The offers, however, proved to be unnecessary for the court later authorized the receivers to borrow money to discharge these specific obligations.

Very soon movements were started for organizing committees of the owners of various classes of bonds to protect the interests of those securities. By the end of January committees had been formed to represent respectively the Seaboard Air Line first mortgage 4 per cent bonds and extended three year 5 per cent bonds. The interests of these two classes of bonds were in some ways opposed. The former represented the first lien on the property and therefore

in any reorganization plan they would feel justified in opposing an arbitrary scaling down of their face value. The latter class, on the other hand, held only a junior or secondary lien so with some justice they could be asked to sacrifice part of their value or to submit to an exchange for income bonds or other form of security. At any event the interests of each class were sufficiently opposed, so that separate protective committees were deemed necessary. These committees conferred and finally agreed upon a reorganization committee which represented various interests concerned. This committee was formed on April 17.

Attempts were immediately made by the receivers to reduce operating expenses, and the first item to which they directed attention was that of salaries of officers. A reduction of wages for the general line of employees was out of the question, for the Southern Railway had only recently been prevented from doing this by action of the Interstate Commerce Commission.[1] Accordingly, on February 22, an order was issued reducing by 10 per cent all salaries over $5,000 per year and by 8 per cent all salaries between $3,000 and $5,000. This was not in effect long enough to make an appreciable showing for the fiscal year 1908, but the results of this policy were evident in the following year. The annual charges for salaries of officers are given below:-

1.Chronicle

Salaries of officers in department of:-[1]

	1907	1908	1909
Maintenance of way and structures	$54,650	$62,703	$58,134
Maintenance of equipment	38,208	40,327	37,047
Traffic expenses	39,208	45,070	44,575
Transportation expenses	52,733	52,859	44,466
General officers	37,222	53,569	49,697
Total	$222,207	$254,528	$234,019

This is an example of the policy of economy adopted by the receivers. The results of this policy were evident at the end of the first month of operation. The report[2] for the month of January 1908 is below compared with that of December 1907:-

	January	December	Change
Total operating revenue	$1,215,680	1,254,959	-39,279
Maintenance of way	169,690	185,911	-16,221
Maintenance of equipment	207,596	200,493	7,103
Traffic expenses	50,294	51,943	- 1,649
Transportation expenses	468,566	558 ,378	-89,812
General expenses	36,283	44,281	- 7,998
Total operating expenses	$932, 431	1,041,018	-108,577
Net operating revenue	283,249	213,951	69,298
Taxes	49,250	49,250	
Operating income	233,999	164,701	69,298

The ratio of cost of conducting transportation to gross earnings in January was less than 43 per cent; in December

1. Annual Report of 1909.
2. Monthly Report in Wall Street Journal, March 25, 1908.

it was 48.6 per cent; and for the fiscal year 1907 it was 47.6 per cent.

It will be remembered that in all the history of the Seaboard since its consolidation in 1900 both classes of stock had been held and voted by a voting trust. John Skelton Williams had favored this system during the early history of the Greater Seaboard Air Line,but after the New York interests gained control he opposed it strongly, pointing out that the voting trust was never intended to be permanent.

By a voting trust the power of management is separated from the ownership,and therefore it is sometimes condemned for separating responsibility and power. However, in a case like the Seaboard where the market value of the stock represents but a very small part of the value of the property, the bondholders' interests will probably be better conserved by a voting trust, which will presumably hold to a single policy over a period of time, than by the general body of shareholders, who are liable to sudden changes of policy, due to change of ownership of the very cheap stock.

As a result of this long standing opposition, an agreement which provided for the dissolution of the voting trust was made on December 31st, 1907, between John Skelton Williams and the counsel for the New York group. In accordance with this agreement,the voting trustees gave notice on March 31 to the holders of the certificates that they had decided to dissolve the voting trust agreement; and that they would make delivery of certificates of capital stock in exchange for the voting trust certificates, and called for said exchange on

May 15.[1]

In spite of the economy exercised by the receivers, it was found necessary to pass the payment of interest on the $12,775,000 of series "a" bonds which was due on April 1.[2] The receivers did however succeed on paying interest on the equipment trust bonds.

It was necessary that the receivers should raise money in some way, so they proposed to the court an issue of receivers' certificates. The proposition was approved by the Circuit Court on April 18. These certificates were to be at 6 per cent and have a lien on all the property of the road prior even to the first mortgage, 4 per cent bonds. They were to be dated May 1, and to run for three years, subject to call after six months. The amounts and purposes of these certificates were as follows:-[3]

Series A

To pay $60,000 for interest and $200,000 on account of the principle of a loan made to the Railroad by the Metropolitan Life Insurance Company (about)		$260,000

Series B

To provide for sundry requirements, (about)		$3,304,000
Claims having statutory preference	$493,063	

1. Moody Manual, 1910 - p. 1021
2. Chronicle, April 4, 1908
3. ibid.

Payments by receivers on account of car trusts, taxes, interest on mortgages, traffic balance, and statutory liens	$ 964,676
Interest due before July 2, 1908 on underlying mortgages, including interest paid April 1, 1908	1,054,975
Payments on equipment agreements maturing before July 2, 1908	577,419
Rentals accrued prior to receivership	9,943
Notes and bonds secured by terminals etc.,	44,900
Sums payable of completion of shops, bridges, etc.,	159,875
Total	$3,303,351

The receivers' certificates were secured as follows:

(1) as a primary security, they were a first lien on the surplus income derived from the operation of the Seaboard property of the receivers, after the payment of expenses of operations and of the receivership.

(2) As an ultimate security, they were a prior lien on the property of the Seaboard Air Line.

The annual interest charge on these certificates was about $180,000. Thus it is evident that they were an exceptionally good investment, and they were easily disposed of

thru a New York syndicate.

In the meantime, the receivers went on making improvements and settling the floating debts of the Company. The Baltimore Sun of August of 18, reported that the Seaboard Air Line receivers were at work on the improvements outlined to the court at the time they were authorized to issue the receivers' certificates. These included new terminals at Tampa, Florida, and iron bridges in place of wooden bridges along the line. 12,000 tons of steel rails were purchased, and piers were provided at Charleston for handling coal from a branch line recently extended into the West Virginia coal fields.[1] It was estimated by the receivers that construction under way in August would entail an expense of about $1,500,000. This policy was continued so that in February of 1909 it was estimated that the improvements at that time projected would cost in the aggregate about $3,500,000.[2]

To provide the funds for this policy of extension, for the acquisition of new equipment, and to pay interest on underlying obligation, the receivers made on January 1, 1909 a new issue of receivers' certificates, to the amount of $4,250,000, to be known as series "c". In security offered they were similar to series "a" and "b". They were to pay 5 per cent and mature in three years, but they were subject to

1. This line was the Carolina, Clinchfield and Ohio, 285 miles in length, built for the purpose of getting an outlet for the coal of the Cumberland corporation in Virginia and West Virginia. The road was financed by Blair and Company and other interests friendly to the Seaboard. (Chronicle, September 12, 1908).

2. Chronicle 88: 376.

call before that time.[1]

Of course, all parties looked forward to the reorganization of the finances of the road that would enable it, with average earnings, to maintain itself. As a first step towards this end, a reorganization committee of fifteen members was formed on April 18, but nothing was done during 1908 to perfect a plan of reorganization.

By the spring of 1909 prospects appeared good for paying interest and having a safe surplus. The country was recovering from the financial depression. Thus it appeared an opportune time to bring forth a reorganization plan. Before stating this plan, however, it may be well to give the results of the two years' operation by the receivers.

The earnings and expenses for the two years had been as follows:-[2]

	1909	1908
Operating revenue	$16,451,676	$15,675,449
Operating expenses	11,446,032	11,979,919
Net operating revenue	5,005,644	3,695,530
Net revenue from outside operations	-13,682	-2,608
Total net revenue	4,991,962	3,692,922
Taxes	623,935	600,500
Operating income	4,368,027	3,092,422
Other income	155,452	48,072
Gross corporate income	4,523,479	3,140,494
Deductions	4,035,298	3,826,367
Net corporate income	488,187	-685,873*

*Deficit

1. Wall Street Journal December 5, 1908
2. Interstate Commerce Commission Report for 1909 p. 496 and 1908 - p. 538.

Operating ratio	69.57 percent	76.42 per cent

The increase of operating revenue was due, of course, to the return of prosperity, but the reduction both relatively and absolutely of operating expenses was due to the policy of strict economy mentioned above. The great reduction of operating ratio - 76.42 to 69.57 will be noticed. The receivers had paid the interests maturing on all the underlying divisional bonds of the system, thus forestalling a possible attempt to break up the system by selling it in parts. They had also paid the interest on the bonds of series "b" and series "c" and on the bonds of the subsidiary lines endorsed or guaranteed by the Seaboard, to the extent that those lines themselves had failed to make such payments. But it will be remembered that interest had been defaulted on the $12,775,000 of first mortgage 4 per cent bonds (series "a") and on the $6,345,000 bonds of series "d". Interest was also in default on the $7,000,000 of 6 per cent note designated above as series "e".

Besides the funded debt, as above stated, there was outstanding June 30, 1909, receivers' certificates, as follows:-

Series	Date	Rate	Amount
A	June 15, 1908	6 per cent	$3,000,000
B	June 16, 1908	6 per cent	260,000
C	January 1, 1909	5 per cent	4,250,000
	Total		$7,510,000

With such results as these the road was ready for a reorganization and discharge from the control of the receivers. In the latter part of April 1909, the general reorganization

committee appointed a sub-committee, which was to construct and present a detailed plan of reorganization. Besides the chairman, this committee was made up of representatives of the following groups and interests: the Continental Trust Company of Baltimore, which was trustee for the first mortgage bonds; the stockholders of the Seaboard Company; the holders of old Seaboard Air Line stock; the holders of collateral trust bonds; a representative for all the stock; and a representative for all the bonds.[1] Early in June, a plan was ready, known as the adjustment plan. This was approved by the general reorganization committee and was dated July 1, 1909.

1. Railway Age Gazette, April 22, 1909.

V

REORGANIZATION PLAN OF 1909

The plan presented, and later adopted, was substantially as follows: - The various classes of securities will be referred to by their series letter as well as by title for convenience of comparison with the above description of the funded debt.

(1) The $7,510,000 of receivers' certificates and the $700,000 of 6 per cent notes, series "e", were to be paid in full with interest. The money for this purpose was to be provided by the method described below in paragraph 6.

(2) The following bonds were to remain undisturbed: the $30,400,000 of divisional bonds series "f"; and the $12,775,000 first mortgage bond series "a"; the $10,000,000 of 5 per cent series "b"; and the $4,651,000 of the collateral trust bonds of series "c".

(3) The capital stock was to remain undisturbed and was not called upon for assessment.

(4) The Seaboard Air Line should continue liable for all its debts and obligations which included its guarantee of interest on the bonds of certain subsidiary companies.

(5) The holders of first mortgage bonds, series "a", were to receive all matured and unpaid interest in cash, but they should agree that their bonds could be redeemed by the company at par and accrued interest at any interest payment date.

(6) A new form of security, known as adjustment bonds,

were to be authorized to the amount of $25,000,000. They were to be cumulative income bonds bearing 5 per cent interest. By the sale of $18,000,000 of these bonds at 70, money would be provided for the retiring of receivers' certificates (see paragraph 1) and for other purposes mentioned below. The sale of these bonds had already been underwritten.

(7) The $6,345,000 of 5 per cent bonds (series "d") were to be exchanged for an equal amount of adjustment bonds described in the above aparagraph. For interest matured on these bonds of series "d", adjustment bonds were to be given at their face value.

(8) This provided for the immediate needs of the company, but from the past experiences of the Seaboard it was evident that some method should be devised for providing new capital for the future development of the property and for the refunding of existing bonds as they matured. To provide for these future needs $125,000,000 of 4 per cent refunding mortgage bonds were to be authorized and held ready for issue when needed.

(9) Besides these adjustments of securities, it was provided to vest in the Seaboard Air Line by sale, merger, consolidation or otherwise, the properties of the following subsidiary railroads: Atlanta & Birmingham Air Line; Atlantic, Sewanee River and Gulf; Catawba Valley Railway; Florida West Shore; Plant City, Arcadia and Gulf; Roanoke and Tar River; Seaboard and Roanoke, Talahassee, Perry and Southeastern and of practically all other railway companies whose stock was largely owned by the Seaboard Air Line Railway.

Having stated the plan as outlined by the committee, we will attempt an analysis and a comparison of some of its features with those of other reorganization plans.

It may first of all be asked if this rearrangement of finances and securities was in reality a reorganization. The conceptions of receivership, foreclosure, and reorganization as applied to railways are often confused. The meanings attached to these words have changed from time to time and with changes in practice. But both in practice and theory to-day, it is possible to have a receivership without a foreclosure or a reorganization. Professor Ripley defines a receivership as " the continuing control of a railway by an officer appointed by a Federal or State Court who in cases of dispute or litigation assumes the management on behalf of all parties concerned, including the public, with its right to uninterrupted service."[1] So the receivers may merely operate the road for a time until it is again on its feet and then discharge it, without a foreclosure sale, or a reorganization of its finances. As to the possible separation in theory of reorganization and foreclosure, there is some difference of opinion. Cleveland says that a reorganization is not possible without a foreclosure.[2] But as Professor Ripley points out, it is quite as possible to have a radical readjustment of capitalization because of extreme prosperity, as because of financial failure. The first reorganization of the Rock Island, in 1880, was due to extremely high earnings

1. "Railroads," Vol. II, Chapter xii.
2. Railway Finance - p. 247.

and the consequent desire to extend capitalization.[1] Almost the same can be said of its reorganization of 1907 under the Moore-Reid interests. In neither case was there a receivership or a foreclosure, but the changes were so radical and far reaching that it seems illogical to refuse to them the term of reorganization. But if we accept Professor Ripley's definition that reorganization is a financial readjustment, or if we follow Stuart Daggett, when he attempts to establish a more definite concept for purposes of study, by restricting the term reorganization to "the exchange of new securities for the principle of outstanding, unmatured, general mortgage bonds, or for at least 50 per cent of the unmatured junior mortgages of any company or for the whole of the capital stock" - if we accept either of these ideas, we must apply the term reorganization to the readjustments of Seaboard finances both in 1905 and 1909.

As to the first item above mentioned - it was of course inevitable that receivers' certificates and the 6 per cent notes should be paid in full. Receivers' certificates hold a practically impregnable position. They have a prior claim to any of the bond issues, and so in a reorganization plan need not compromise at all. The $700,000 of short time notes, being secured by good collateral, were also in a position where no sacrifices could be demanded of them.

The large proportion of bonds that remained undisturbed was an evidence of the very conservative nature of this reorganization. Taking up each of these four classes of bonds,

1. Daggett, Railroad Reorganization - p. 313.

mentioned in paragraph 2.of the reorganization plan, let us see what claim each of them had on tangible property. The $30,400,000 of divisional bonds series "f" were in the strongest position. They largely represented the indebtedness of the various lines before the consolidation. Consequently, most of these bonds had a prior lien to the first mortgage bonds, and if they insisted the various divisions would be sold separately at foreclosure. True, many of these branches would be of little value except as a part of the system. Therefore, such an extreme measure was very improbable, but it was a possibility - and an effective one.

Next in order of priority of claim came the $12,775,000 of first mortgage bonds, series "a". These were part of an authorized issue of $75,000,000. They had a first claim on the system as a whole.[1]

The collateral trust bonds series "b", also had a very substantial claim for they were secured by a deposit of $20,000,000 first mortgage bonds series "a" which has just been discussed. Consequently they too were left undisturbed.

Then there were the collateral trust bonds of series"c". It will be remembered that these were the bonds which were issued in 1904 and with each of which was given a bonus of $900 of preferred stock and $1600 of common stock. Considering this excessive liberality, the holders of these bonds could

1. As these bonds represent the whole system their quotations on the bond market act as a barometer of the confidence of the investing public in the road. A chart has been included in the appendix to show the fluctuation in the Seaboard Air Line first mortgage bond.

have had no just complaint if they had been called upon to sacrifice part of the value of their bonds or to submit to a lowering of their interest rate. Evidence is not available however that this was even suggested.

Let us next consider the provisions of paragraph 3 of the reorganization plan. This referred to capital stock. As a general rule the stockholders have little goice in a reorganization. They are the proprietors; the bondholders are the creditors. As the stockholders have had the management of the property and have brought it to failure, it is only just to demand that their creditors should be satisfied, and that the stockholders should bear the cost. This adjustment of loss is usually brought about by an assessment of stock. While this of course means a sacrifice, it leaves the control in the hands of the stockholders, and gives them a chance to share in the future prosperity of the road. The amount that can be demanded depends, of course, upon the prospective earning power of the stock, otherwise the stockholders would refuse to pay the assessment and yield up their stock. This assessment of stock, or raising money from within, as it is sometimes called, is, according to Professor Daggett, "the soundest method of raising cash. It disposes of the accumulated quick liabilities once for all; and involves no subsequent increase in interest charges."[1] In nearly all cases have the stockholders regained their added investments by an increase in value of the stock. In almost every reorganization of recent years, there has been an

1. Railroad Reorganization - p. 354.

assessment of stock. That there was none in this case is undoubtedly due to (1) a large number of bondholders being at the same time stockholders,and thereby exerting great influence in the reorganization committee. This is quite possible,for much of the stock had been issued as a bonus to bond purchasers. Whether or not they still remained in the hands of the original owners,is largely a matter of conjecture. (2) Another reason perhaps, was the low market value of the stock. It would have been impossible to collect a very substantial assessment on stock on which the holders placed little value, and further,(3) the floating debt was not such a problem as in most reorganizations and,therefore, ready cash was not so badly needed.

As to the fourth item of the plan,the company could hardly avoid liability for its floating debt,as no court would countenance a refusal by the company to pay for supplies and labor it had received. As for its guarantee of the bonds of its subsidiary companies,the practice of reorganization committees is somewhat different. Very often are burdensome guarantees, contracts,or leases abrogated.[1] However,in this case it was not an important question for the most important of the roads whose bonds had been guarnateed were,by the reorganization plan,consolidated with the Seaboard Air Line.

The first mortgage 4 per cent bonds,as was to be expected, were to receive all matured and unpaid interest. Three

1. One example of such cancellation of a lease is found in the action of Judge Jenkins of the Milwaukee Court in September 1893 when he allowed the Northern Pacific to cancel its lease of the Wisconsin Central property because the receivers reported that during the three years of the least it had represented a loss. - (Chronicle, Sept. 30, 1893.)

semi annual interest dates had been passed without the payment of interest. As a fair return to the company for the payment of this pasted due interest, it was demanded that the bonds should be made redeemable at par. This concession might at some time be of value to the company but has not proved so to date for the reason that these bonds have never reached par, and to redeem them would mean a considerable loss to the company. These bonds ranged between 83 and 85 during the latter half of the fiscal year 1914.[1]

The issuing of income bonds known as adjustment bonds to raise cash and to exchange for the general mortgage bonds, series "d", was in line with modern financial practice.[2] It would probably have been wiser to raise the needed money from within, that is, by assessment of stock. But if additional securities were to be sold, this form was undoubtedly the most desirable. Income bonds sell better than preferred stock, probably because of the habit of considering anything called a bond a better security than stock. As a matter of fact,

1. Chronicle July 27, 1914.

2. The bonds are dated October 1, 1909 and mature October 1949. Interest is payable semi-annually at a rate not to succeed 5 per cent per annum as determined by the Board of Directors. The company agrees that no dividends shall be paid upon its stock until all interest in arrears, if there be any, shall have been paid. The Board of Directors may at any time direct the payment of any or all interest in arrears whether on regular interest dates or not. Furthermore, the company may if it desires pay interest otherwise than from net earnings and income. - Moody's Manual 1910. - p. 1023 (Not verbatim)

the lien of an income bond is of little value and furthermore the holder of an income bond cannot participate in the control of a company. Nevertheless, as income bonds are preferred by the investing public to preferred stock, their use is increasing. They were of course, preferable to ordinary interest bearing bonds on which charges must be paid on pain of bankruptcy. Professor Daggett has shown that the tendency of practice since 1893 as compared with the practice before that date has been to reduce such charges. In the reorganizations which he examined before 1893, there was a slight increase of fixed charges; in those from 1893 to 1898 there was a decrease of fixed charges of 30.9 per cent.[1] The use of the income bond or some kind of stock to displace the regular interest bearing bond is, of course, one method of bringing about this desired end.

$18,000,000 of these adjustment bonds were to be sold at 70 per cent.[2] The reorganization committee stated the proposed disposition of the cash to be received from this sale as follows:-

Proceeds from the sale of $18,000,000 adjustment bonds at 70, after deducting 5 per cent underwriting commission $11,700,000

Receivers' certificates	$7,510,000	
Two year notes and interest	763,000	
Three coupons of series "a"	766,000	
Leaving applicable toward		
floating debt, interest,		

1. Railroad Reorganization - p. 357.
2. Range of this security in 1913 - p. 66-75.

expenses of receivership,
expenses and compensation
of the committee, etc. 2,661,000

$11,700,000 [1]

We now come to that clause of the reorganization plan which provided for the exchange of the 5 per cent bonds, series "b", for the above described income bonds. The bonds of series "b" were secured (1) by a general mortgage on the property of the Seaboard Air Line and (2) by the deposit in trust of (a) certain stocks of other companies and (b) $20,000,000 first mortgage series"a". Tho secured by a "general mortgage" they had a very unsubstantial claim on actual property, for the mortgage by which they were secured was preceded by that of series "a" on the property of the road. Their claim on the $20,000,000 bonds of series "a", held in trust, was preceded by that of the collateral trust bonds, series "c", and that by the collateral trust bonds, series "b". In brief then, their security was (1) a second lien on about 350 miles of road, (2) a third lien on about 2,030 miles of road, (3) a third lien on $20,000,000 first mortgage bond series "a" and (4) a second lien on $7,068 of stocks and bonds of various companies. It will remembered (page 21) that these bonds were part of an authorized issue of $18,000,000 which were dated February 1, 1907. The authorization of these bonds was part of the reorganization plan of 1905. The issuing of $6,345,000 was part of the policy of improvement and expansion which seized the management in the latter part of

1. Railway Age Gazette 47:82.

1906 ,and was carried out thru 1907,leading to the deficit at the end of that fiscal year. Most of them had been disposed of them to stockholders at 90 at the same time (February 2, 1907) that the three year collateral trust bonds series "c" were selling at one-half point above par, and the first mortgage bond series "a" were quoted at 81.[1] If one class of bonds was to be picked out to bear the loss incident to a reorganization, this class was undoubtedly the proper one for such purpose. The security upon which they rested was, as we have seen, not very substantial. The purchasers were aware of this when they bought the bonds,so no injustice would be done by requiring them to bear the loss as one of the fortunes of speculation.

The new 4 per cent,refunding mortgage,bonds,mentioned in paragraph 8.of the plan,may be described as follows:- The amount authorized was $125,000,000 and the time of maturity 50 years from date of issue. They were subject to call at 105 and interest at any interest date. $75,000,000 of them were reserved for the following purposes:-[2]

To retire underlying divisional bonds	$30,405,000
To retire first mortgage series "a"	12,775,000
To retire three year bonds series "c"	4,651,000
To retire ten year bonds series "b"	10,000,000
To retire equipment trust obligations	6,000,000
For double tracking, reducing grades,etc.	4,000,000
For other betterments, improvements etc.	4,424,000

1. Chronicle 84:260
2.. Moody's Manual 1910 - p. 1024.

To aid in collateral trust and first mortgage bonds but only at request of three-fourths of Board of Directors	2,750,000
	$75,000,000

The remaining $50,000 authorized, could only be issued at a rate not exceeding $2,750,000 per year and only under specified conditions. The security, of course, would be that of the bonds retired and in addition the $5,500, first mortgage bonds, series "a", formerly in the treasury or pledged for the floating debt. The first offering of these bonds was for $19,000,000 at 83 per cent in April 1911 to retire the three year, and five year, 5 per cent bonds coming due at that time. There were outstanding June 30, 1914, $24,010,000 of this class of bonds.

The last item of the reorganization plan dealt with the merger of the various lines whose stock had been held largely by the Seaboard Air Line. The various roads involved are mentioned above. This was the final step in that actual consolidation which, as we have seen, began in 1897 and 1900, was pushed further in 1905, and now was completed by combining the property all under one name. This is an illustration of the fact that financial failure of a road tends toward disintegration, but a reorganization tends to greater consolidation. The effect here was not as it often is to reduce rents for the consolidated lines had not been leased. Neither did it reduce the number of bond issues for the bonds of the various companies remained as divisional bonds under the Seaboard Air Line.

Summary:- The reorganization of 1909 was extremely conservative. It was called for by the stockholders, and they wielded a great influence thruout the receivership and reorganization. The stock was not assessed. Most of the bonds, even those of junior lien, were not disturbed. Fixed charges were somewhat reduced by the substitution of income bonds for fixed interest bonds. Provision was made for the capital needs of the growing company. A considerable improvement in the property had been made under receivership. Having accomplished these results, the receivers, in November 1909, turned over the control of the property to the stockholders.

VI

THE SEABOARD AIR LINE SINCE 1909

Since the reorganization of 1909 there has been a steady improvement of the Seaboard's financial standing. How much of this has been due to the conservative readjustment of finances of that year, it is hard to say. Certain it is, however, that much of this improvement must be ascribed to the general development of the industries of the South. In the six years the gross earnings from operatioh have increased from $17,634,496 to $25,291,758. During the same time operating expenses (before deducting taxes) increased from $12,216,803 to $17,311,395. Or stated in terms of percentage - the operating ratio of 69.84 in 1909 and had only decreased to 68.44 in 1914.

The adjustment bonds created by the reorganization of 1909 were all sold by December 1910. It will be remembered that the stockholders of the road had been given an option on these securities at 70. It was expected that a considerable share of them would be taken in this way but the shareholders availed themselves of this option only to the extent of $1,500,000. They consequently sold thru a syndicate and a considerable portion, estimated between $5,000,000 and $15,000,000 were taken by English investors. As a result of this purchase, W. K. Wigham of London was elected to the Board of Directors. These securities by the time they were all sold were quoted at 76.

In the latter part of 1911 and the early part of 1912 there was taking place a quiet purchasing of stock by certain Southern shareholders, with the result, of course, that the demands of this class were coming to be more and more respected. We will return again to this subject of shifting control but mention it here as a probable cause of the dissolution of the Seaboard Company. The Southern capitalists, it will be remembered, had never been entirely in sympathy with the idea of the holding company, but had continued to protest against it and the policies of its backers. After a few years' trial they seemed to have a better case than ever for the Seaboard company had been formed to furnish needed capital especially in the event of a business depression. It had utterly failed to accomplish this desired result. So in the autumn of 1911 it was finally decided by the holders of Seaboard Air Line stock (which meant very largely the Seaboard company itself) to dissolve the holding company. On January 2, 1911, the plan of dissolution was submitted to the vote of the stockholders and was unanimously approved. The share of the proceeds to go to each class in the event of dissolution had been determined by the Seaboard Air Line shareholders in 1905 at the time of the forming of the new company. The condition of the company at the time of the dissolution was as follows. The Seaboard company had in the latter part of 1911 sold to a syndicate of which Blair and Company and Ladenburg, Thalman and Company were managers, $6,700,000 of its holdings of Seaboard Air Line adjustment lines, and had sold to the bankers themselves for their own account the small remainder

of such holdings amounting to about $85,900. These bonds, a small amount of cash on hand, and $900,100 Seaboard Air Line railway notes payable on demand constituted the entire cash of the company except its holdings in Seaboard Air Line railway preferred and common stock.[1]

The holdings of the Seaboard company were to be distributed as follows: (1) The holdings of common stock of the railway company among the common stockholders of the Seaboard company, about 1.03 shares of railway common stock being given for each share of Seaboard company common stock, (2) its holdings of preferred stock of the railway to be distributed among the second preferred stockholders, about one and one-third shares of railway preferred stock to each share of Seaboard company second preferred stock, and (3) the proceeds of all its other assets among its first preferred stockholders which it was estimated would provide par in cash for each share of Seaboard company first preferred stock. It will be remembered that in forming the Seaboard company each share of the Seaboard Air Line stock was required to pay an assessment of $12.50 and to be surrendered to the Seaboard company. In return among other things it received $12.50 of Seaboard company first preferred stock. So the paying for these securities in cash at their face value was justified by the assessment of seven years prior.

Another interesting development in Seaboard affairs took place in 1912. This was the purchase of a majority of stock by Southern investors and the consequent shift in control from New York to the South. S. Davies Warfield,

1. Chronicle 1911, December 9.

of Baltimore, purchased a block of 90,000 shares of preferred and 120,000 shares of common stock from the Cumberland Corporation. We referred above to a proposed alliance of the Seaboard Air Line with the Carolina, Clinchfield and Ohio. This road and certain coalfields, mentioned above, in connection with the road, were held by the Cumberland Corporation. The holding of Seaboard Stock was evidently part of the plan of forming a community of interests. The only importance of this in the present connection is that the Cumberland Corporation, needing funds to meet certain maturing notes, decided to provide them by the sale of Seaboard stock.[1] In making this purchase, Warfield was representing a syndicate of the leading capitalists of the state of the South traversed by the Seaboard Air Line; also certain New York men. The former were in the majority. The block of stock was to be placed in the hands of trustees for five years, Mr. Warfield being chairman of the managers. The syndicate, it was announced, would control a majority of the stock ($37,019,000 common and $23,894,000 preferred) of the Seaboard Air Line railway.

There was considerable enthusiasm for the new management. The Seaboard was proclaimed as a distinctly southern property, and it was asserted that now the South's position in Seaboard affairs would be emphasized. The Board of Directors was to include representative business and financial men of the Southern states and thereafter the meetings of the directors would be held at the offices at Baltimore, the "natural gateway of the South."

To represent the new control W. J. Harahan, at that time

1. Chronicle May 25, 1912.

vice-president of the Erie Railroad,and formerly general manager of the Illinois Central,was elected president. There had been considerable dissatisfaction with the old management. The operating ratio in 1912 had been 71.02 as compared with 66.48 in 1911. With larger gross earnings from operation than ever before the year had ended with a net corporate income of less than that of 1911. But now,with the new Southern directors and their new president, confidence again returned.

An aggressive policy of betterment and extension was immediately adopted. In February of 1913,$6,000,000 of three-year,5 per cent notes were issued to be used for improvements. About the same time the Tampa and Gulf Coast railroad, a line of 77 miles was built and the Seaboard Air Line guaranteed the payment of interest on its bonds. In like manner a close connection is maintained with the North and the South Carolina railroad, though in neither case does the Seaboard Air Line own the capital stock of the smaller company,nor is their milage included in the total milage operated by the Seaboard Line railway.

During the fiscal year 1914,as will be noted by the income accounts,a fair increase of gross earnings over any preceding year was reported. $716,823 were paid out as dividends on the preferred stock. A fair amount was spent on maintenance of equipment and maintenance of way. All in all it was a good year. The coming of the depression in the South due to the European war has,of course, lowered gross earnings. The directors immediately decided to pass dividends on the preferred stock. This brings us to the end of the last fiscal year.

At the outset of any attempt to arrive at a general statement of the progress of the Seaboard since its consolidation in 1901,it must be said that the high hopes and extravagant predictions of success have not been entirely realized. A rapid brilliant rise was expected as a result of the consolidation. But the increase in size of the system, the change in form of traffic handled, and the consequent needs of adopting new methods and new equipment,gave rise to unforeseen problems. However the years 1901 to 1914 have brought a slow but,on the whole,a steady growth. The increase in milage has not been large.as compared with that of some other roads,but the reason for this seems to be that the system as established in 1901 made a rather natural unit of operation. Its need was more for intensive than extensive development. The addition of certain branch and connecting lines has increased the miles operated from 2,484 in 1901,to 3,084 in 1914.

In 1901,the gross earnings from operation were $10,426,279; they have increased rather consistently to $25,291,757 in 1914. Passenger earnings increased from $1,978,780 to $5,430,531; freight earnings have increased from $7,282,432 to $17,307,034. Incidentally,there is in these figures good evidence of the industrial development of the South Atlantic Seaboard states.

With the increase of earnings the percentage devoted to maintenance of way, structures and equipment has not declined. It was 25.23 per cent of gross earnings in 1901 and 25.69 per cent in 1914. Besides the improvements charged to income account, there have been various issues of securities as we have noted above,for improvements of property.

The weight of rails has been improved. The following table shows the weight of rails in the main line in 1901 and 1914 respectively:-

Weight of rails per yard	1914	1901
90 pounds	11 miles	
85	346	39
80	75	124
75	1207	
70	166	189
68	210	201
65	18	20
63.5	60	5
60	536	1321
58	205	
56 and lighter	258	552
Iron rails		88

Thus it is seen that the weight now most common on the Seaboard lines,exclusive of sidetracks and second tracks,is 70 pounds steel,as contrasted with 60 pounds steel in 1901. Nevertheless, there is still much to be done for from the above table we find that 1243 miles of line still have rails of less than 70 pounds per yard - that is, rails incapable of handling traffic by the most modern methods.

The Seaboard when incorporated had 294 locomotives; on June 30, 1914 it had 525. The number of passenger cars and freight cars were respectively 259 and 8335 in 1901, and 371

and 17,851 in 1914.

Another indirect evidence of improvement is the reduction of percentage of gross earnings consumed by fixed charges and conducting transportation from 72.4 to 63.1. This, it will be noted, is a different thing from "operating ratio", which is the term used to describe that proportion of gross earnings used in operating expenses, of which conducting transportation is but one part, and which of course does not include "fixed charges". The operating ratio of the Seaboard was 70.98 in 1901 and 68.45 in 1914. Normally, according to Professor Ripley, it lies between 50 and 75. For the railways of the United States as a whole it has risen from 64.6 in 1900, to 71.7 in 1913. The Southern Railway in 1914 had an operating ratio of 74.1 and the Atlantic Coast Line in the same year 71.9.[1] Methods of accounting, financial policy, etc., remaining the same, a decline of operating ratio is an evidence of efficient operation. It has a great effect on the price of securities for the difference between the operating ratio and 100 per cent measures roughly the so-called margin of safety of both stocks and bonds.

A matter which is not directly connected with railway finance but which is of fundamental importance in the success of a road is the density of traffic, passenger and freight. In the respect the roads of the granger territory, as for example, the St. Paul or the large roads of the trunk line territory are facing an entirely different situation than the roads of the South generally, and particularly those of the Southeast. This condition, however, is bound to improve with the development

1. Exclusive of Taxes.

of the South, and it must be said that the railways are doing their part thru their "industrial departments" to help along this movement. On the Seaboard Air Line the density of freight and passenger traffic respectively, grew from 236,465 to 510,668 and from 30,464 to 80,309 in the period 1901 to 1914.[1]

In considering the financial stability of a company capitalization must be examined. Professor Ripley, in the book referred to above, considers the question of safe or unsafe capitalization to depend upon the relativity of capitalization and earning power. Under the term capitalization he includes all classes of bonds and preferred and common stock.[2] Would it not be more accurate in many caaes, of which the Seaboard is an example, to say that the question of safety depends upon the relativity of earning power and fixed charges. The fact that the Seaboard has $45,995 per mile capitalization (meaning by capitalization both stocks and bonds) is not as significant as an evidence of stability, as is the fact that it has $36,243 of bonds on which interest must be paid under penalty of foreclosure. Dividends have never been paid on the common stock of the Seaboard Air Line. Therefore, whether the Seaboard has $12,004 of common stock per mile as it had in 1914 or $50,000 per mile, has little if any bearing on the safety of the company.

However, even comparing the bonded indebtedness of the Seaboard with its net earnings, as we maintain should be done, the showing is not good. But this seems to be because the earning power is low, due to poor territory rather than because the bonded debt is too high. This undesirable proportion

1. Annual Reports of Seaboard Air Line.
2. Railroads, Vol. II,- p.85

would therefore be shortly remedied by an increase of earnings. The industrial awakening in the South necessary for such an increase of earnings appears to be in progress and with it the Seaboard along with other Southern roads will undoubtedly enter upon better times.

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